

# CONSTRUCTION LAW UPDATES

September 2008

## CONTRACT DAMAGES

### *HOW IS A \$14.5 MILLION DOLLAR AWARD POSSIBLE ON A \$400,000 JOB?*

By Steven K. Stawski, Attorney

Recently, a court issued a \$14.5 million award against a construction manager for the delayed completion of a casino's \$400,000 ornamental façade. The owner calculated construction damages by adding the profits lost from customers who did not enter the building because of the delay in finishing the decorative work.

In *Llamas Group v Huron Valley Schools*, the Michigan Court of Appeals found that the trial court erred by precluding the contractor from presenting evidence of over \$1 million in damages caused by the loss of bonding and impairment of its ability to bid on public sector jobs.

Generally speaking, damages for a breach of contract are calculated by placing the non-breaching party in the same position as if the contract has been fully performed. The rule, laid down by an English court in 1854, survives today: Damages recoverable for breach of contract are those that arise naturally from the breach or those that were in contemplation of the parties at the time the contract was made.

While it sounds simple, this 150-year-old rule does not answer the million-dollar question applicable to today's lawsuits: What does it mean, specifically, to place the non-breaching party *in the same position* as if the contract had

been fully performed?

Parties seeking to increase their damages may claim that their "same position" must be measured from a larger scope of reference by including indirect costs, such as loss of profits and opportunity losses, that affect their company as a whole. These indirect, or additional costs, are called "consequential damages."

In the *Huron Valley Schools* case, the Court employed a flexible interpretation of the centuries-old rule, which provides that damages "which can *reasonably* be said to have been in contemplation of the parties at the time when the contract was made" are recoverable. As a public entity whose contractors must be bonded, the school knew or should have known that the contractor would suffer a loss of profits if it committed a breach that resulted in the contractor's loss of bonding capacity.

To control and reduce the risk of inflated awards, owners and contractors can agree in writing not to sue each other for consequential damages. The standard AIA contracts often include a "Waiver of Consequential Damages" provision, but the lack of a clear definition remains a concern.

The 1997 AIA B141 Standard Form Agreement between the owner and the architect provides

that “The Architect and the Owner waive consequential damages for claims, disputes or other matters in question arising out of or relating to this Agreement.” Because the term “consequential damages” is not defined, this waiver is subject to litigation.

The 1997 and 2007 AIA A201 Standard Form Agreement between the owner and the contractor attempt to clarify the waiver provision by identifying some common types of owner and contractor related consequential damage claims. However, it is a non-exclusive list.

According to the AIA A201 Waiver of Consequential Damages, the owner’s waiver *includes*, but is not limited to:

- Rental expenses;
- Losses of use;
- Income;
- Profit;
- Financing;
- Business and reputation; and
- Loss of management or employee productivity or of the services of such persons.

According to the AIA A201 Waiver of Consequential Damages, the contractor’s waiver

*includes*, but is not limited to:

- Principal office expenses, including the compensation of personnel stationed there;
- Losses of financing;
- Business and reputation; and
- Loss of profit except anticipated profit arising directly from the work.

These standard form AIA contracts do not use a uniform definition of the term “consequential damages” or provide an inclusive list of examples. The AIA 201 contract omits architects and engineers from the waiver, which places design professionals in the position of possible targets for claimed consequential damages. As such, the centuries-old debate over what kinds of consequential damages are included, or waived, will continue.

The solution is to establish a definition for the term “consequential damages” tailored to the specific project at issue, coordinate waiver protections at the time of contracting, and include all such definitions in the contract documents.

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## DO MY SWORN STATEMENTS REALLY NEED TO BE NOTARIZED?

By Benjamin H. Hammond, Attorney

The Michigan Construction Lien Act contains a form sworn statement that includes a section to be completed by a notary public. A common question of general contractors is whether or not they actually must have each and every sworn statement notarized in order for them to be valid and relied upon.

In 2003, the Court of Appeals ruled that a general contractor’s sworn statement need only *substantially* comply with the Michigan Construction Lien Act and further held that a

statement that is not sworn before a notary does not defeat the notice purpose of the statement.

Recently, the Court of Appeals again addressed this issue in *The Big L Corporation v. Courtland Construction Company, et. al.* In that case, Courtland Construction Company (“Courtland”), acting as the general contractor on a residential construction project, signed nine “sworn statements”. However, none of these statements were notarized. The homeowner’s bank paid Courtland pursuant to the statements, but

Courtland failed to pay a subcontractor/supplier \$19,000.

The subcontractor/supplier recorded a construction lien and filed a lawsuit to foreclose on its lien. Courtland was named as a defendant and argued that it was entitled to dismissal of the lawsuit for two reasons. First, its unverified “sworn” statements substantially complied with the requirements of the Michigan Construction Lien Act. Second, the subcontractor/supplier failed to timely file a notice of furnishing.

Generally, if a subcontractor fails to provide a timely notice of furnishing, it will be unable to pursue a construction lien for labor and materials furnished before the notice was provided. This prohibition only applies if the owner makes payments to the general contractor pursuant to the general contractor’s sworn statements or lien waivers. If Courtland’s sworn statements were valid, then the subcontractor/supplier would not be able to proceed with its foreclosure action. If the sworn statements were invalid, it could proceed. The key issue hinged on whether the unverified sworn statements substantially complied with the Construction Lien Act.

The Court ultimately reaffirmed its prior holding that a sworn statement that is not notarized can

substantially comply with the Construction Lien Act in certain circumstances. It held that Courtland’s sworn statements substantially complied because they were compliant with the form provided in the Construction Lien Act, including being signed and dated, even if not sworn before a notary. The statements gave the owner notice of who the subcontractors/suppliers were and the amount owing to each of them for the materials and labor supplied. The court held that the plaintiff/subcontractor was not entitled to any sums it claimed prior to the date it filed its notice of furnishing.

Thus, although the sworn statement form provided in the Construction Lien Act indicates they must be notarized, they may still be valid if they comply with the rest of the form, including being signed, and dated, and identifying all of the subcontractors/suppliers and the amounts owing to each of them. Of course, best practices would simply have each sworn statement notarized in order to avoid a potential legal battle over the issue.

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## **TOWNSHIP PREVAILS OVER LANDOWNER IN BATTLE OVER WHO OWNS STRIP OF LAKEFRONT PROPERTY**

**By Kristen E. Ray, Attorney**

**B**ased on the legal term “adverse possession,” the Michigan Court of Appeals, in the recent decision *Jonkers v Summit Township*, ruled that Summit Township now owns a piece of property along Bass Lake even though it had formerly been owned by the Jonkers.

In this case, the Jonkers owned property directly across the street from the lakefront property

which the Township had been using as a boat launch. The Jonkers argued that they owned the lakefront property because it was included in a land survey of their property done many years ago.

Though the Court agreed that the lakefront property was included in the land survey, it held that “adverse possession” gave the Township ownership of the lakefront property.

**A person or entity, such as the Township, acquires the land by adverse possession when it remains in possession of the land in a manner that is actual, visible, open, notorious, exclusive, continuous, and uninterrupted for a period of 15 years.**

In this situation, since the Township had maintained the once private land as a public boat launch for at least 15 years, the Court found that

it now owned the lakefront property. Since the Jonkers did not address the issue until after the passage of 15 years, the Township acquired the land by adverse possession.

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## **E-WHAT? FEDERAL CONTRACTORS NEED TO KNOW**

**By Rachel Brochert Roe, Attorney**

**E**-Verify is the latest attempt by the Department of Homeland Security to stem the flow of illegal workers in the United States. So what is E-Verify and why do general contractors need to know about it?

E-Verify is a mostly voluntary, web-based system by which employers can, during the hiring process, input a prospective employee's social security number into a federal government database and verify whether the social security number is valid and belongs to the person who claims to own it. In the event that E-Verify identifies a mismatch between the employee and the social security number, the employee has eight business days to protest and resolve the discrepancy, during which time the employer cannot terminate him or her.

On June 6, 2008, President Bush signed an executive order that requires all federal contractors to agree to use the E-verify system to verify the employment eligibility of "all people hired to perform employment duties" and "all persons assigned by the contractor to perform work within the United States on the federal contract."

Since June 6, proposed rules have been circulated which would implement the Executive Order. As they are merely proposed rules, the Executive Order is not yet a mandate. The mandate will only apply after final rules are published, which is expected to

happen by the end of the year. If the proposed rule is implemented, it will require Federal Contractors to use E-Verify for all of its employees, not just those assigned to a federal project. It would also hold a federal contractor responsible for ensuring that all sub-contractors with a contract in excess of \$3000 use E-Verify for all of its employees. The one good piece of news is that the proposed rule would only apply to new federal contracts, not projects that are currently underway.

Unfortunately, the executive order and the proposed rules raise as many questions as they answer. For instance, how is a federal contractor to confirm that its sub-contractor used E-Verify? What if the federal contractor does not have the sophisticated computer hardware or software to link to E-Verify? What record-keeping requirements will be required? How will the eight day protest period for a social security number mismatch affect time sensitive projects?

Smith Haughey's Construction Industry Team will continue to monitor this important development and provide updated information as it is available.

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## CONGRATULATIONS TO OUR CLIENT, SPRINGFIELD ROOFING

Smith Haughey Rice & Roegge's client Springfield Roofing of Kingsley, Michigan has been named "2008 Hagerty Small Business of the Year" by the Traverse City Chamber of Commerce. The business was awarded the title based in part on their commitment to community service and strong employee relations. More than 100 businesses were nominated for this award.

## MARK YOUR CALENDAR!

Smith Haughey's annual construction law seminar will be held on Thursday, October 23, at Watermark Country Club in Grand Rapids.

### Program:

#### **Part 1 - Mock Arbitration: So You Think Your Arbitration Is a Sure Winner?**

Observe two top construction litigators tackle real life construction issues, cross-examine witnesses, and dissect construction documents under the watch of a presiding Circuit Court Judge. Then judge the parties' claims as you see fit.

#### **Part 2 - Roundtable Discussions**

- ◆ Green building
- ◆ Indemnification
- ◆ Construction liens
- ◆ Professional licensing
- ◆ Project financing
- ◆ And more!

For more information, visit the Events section of our web site at [www.shrr.com/events-smith-haughey](http://www.shrr.com/events-smith-haughey).

## SHRR CONSTRUCTION LAW INDUSTRY TEAM NEWS

**Chip Behler** has been selected for inclusion in the 2009 edition of *Best Lawyers in America* in the areas of construction law and construction litigation. *Best Lawyers* is regarded as the definitive guide of legal excellence in the United States.

**Chip Behler** and **Craig Noland** have been selected for inclusion in the 2008 edition of *Michigan Super Lawyers*. In addition, **Rachel Brochert Roe**, **Steve Stawski**, and **Jason Thompson** were included in the "Rising Stars" category of *Michigan Super Lawyers*. *Michigan Super Lawyers* is an annual listing of outstanding lawyers who have attained a high degree of peer recognition and professional achievement.

**Chuck Judson** was elected Chair-elect of the Alternative Dispute Resolution Section of the State Bar of MI.

**Steve Stawski** was selected to serve as Co-chair of the State Bar of Michigan's Real Property Law Section's Construction Law Committee. In addition, Steve co-authored an article titled, "Managing UCC-Based Litigation: A Practitioner's Guide," which was recently published in the *Michigan Defense Quarterly*. Also, Steve recently attended two continuing legal education seminars: "The Newest AIA Family of Documents: Will Integrated Project Delivery Make Conflict Obsolete?" sponsored by the ABA Section on Real Property, Trust and Estate Law and the ABA Center for Continuing Legal Education and "What Goes Down, Must Come Up: Advising Clients About Real Estate in Michigan," sponsored by the State Bar of Michigan, Real Property Law Section.

**SMITH HAUGHEY RICE & ROEGGE'S  
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